REPORT BY THE

AUDITOR GENERAL

OF CALIFORNIA

THE BOARD OF EQUALIZATION NEEDS TO ADJUST ITS MODEL FOR SETTING REIMBURSEMENT RATES FOR SPECIAL TAX JURISDICTIONS

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The Board of Equalization Needs To Adjust Its Model for Setting Reimbursement Rates for Special Tax Jurisdictions

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Office of the Auditor General
California

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Honorable Robert J. Campbell, Chairman
Members, Joint Legislative Audit Committee
State Capitol, Room 2163
Sacramento, California 95814

Dear Mr. Chairman and Members:

The Office of the Auditor General presents its report concerning the development of a reimbursement rate which special tax jurisdictions pay the Board of Equalization for administration of local transaction and use tax programs.

Respectfully submitted,

KURT R. SJOBERG
Auditor General (acting)

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Summary

Results in Brief

The Revenue and Taxation Code, Section 7270, requires counties that have special tax jurisdictions (STJ) to contract with the Board of Equalization (board) to administer local transactions and use tax programs. Currently, the board administers the collection and distribution of tax revenues for 27 STJs. We reviewed the board's method of setting a reimbursement rate for this administration and found that the board needs to refine and correct its model for determining this rate. During our review of the model that was the basis for the current rates, we noted the following:

- The basic model developed by the board, which shares the cost of the tax collection system, is defendable because sharing the cost does not conflict with the applicable state statutes and because the State, cities/counties, and STJs benefit from the tax collection system, and each pays for the tax collection system to the degree that each benefits from it;

- The board's rate for reimbursement includes an overstatement of charges to STJs for $2.5 million for a portion of the costs related to registering taxpayers, processing returns, auditing taxpayers, and collecting delinquent taxes in counties that do not have STJs;

- The board's reimbursement rate for STJs in counties with two STJs is overstated, and its rate for STJs in counties with one STJ is understated because the board misallocated $2.2 million in costs between the two groups of STJs as a result of allocating costs on the basis of revenue benefit rather than on a work load basis;

- The State subsidizes the STJs or the STJs subsidize the State for administration because the board's model does not adjust the rates for over or under collection of reimbursement in prior periods;

- Because of some errors in the board's calculations, its rate for reimbursement includes an understatement of charges to STJs of approximately $500,000, which amounts to 2.4 percent of the total amount charged to STJs in the development of the reimbursement rate; and

- The board has limited assurance, when determining costs in some areas, that costs allocated to STJs are reasonable because it does not use work load standards that are quantifiable.

Background

The board is responsible for 18 tax programs that support state and local government activities. Among the taxes that the board collects are sales-and-use and transaction-and-use taxes, which the board distributes to the State, counties, cities, and STJs. STJs are created by voters to support transit agencies or other government services. In 1987, the State enacted the Local Transportation Authority and Improvement Act, which indicated that local agencies need to develop and implement local funding programs to remedy the inadequacies of federal and state funding. These local funding programs would help local agencies to deal expeditiously with current and future local transportation maintenance and improvement needs. Most of the STJs are local transportation authorities.

The board administers the State's sales and use tax, which changed from 4.75 percent to 6.0 percent in July 1991, the 1.25 percent Bradley-Burns Uniform Local Sales and Use Tax (Bradley-Burns tax), and transaction and use tax ordinances for STJs. Currently, there are 27 STJs. Beginning on July 1, 1991, the board started charging the cities and counties 0.79 of one percent of tax revenues collected for the Bradley-Burns tax. At that time, the board started charging STJs 1.49 percent of STJ revenues collected

for STJs located in counties with a single STJ; it started charging 1.30 percent for those located in counties with two STJs.

The Board's Rate-setting Model Is Defendable

The board's policy is to share the costs of the tax administration system among the parties that benefit from the tax collection system based on a percentage of revenue collected. This is a defendable policy. The board recognizes that the State, cities/counties, and STJs each have an interest in the established tax collection system in the amount of their respective percentages of total revenues, and accordingly, each should pay for the tax collection system to the degree that each benefits from it. In addition, the board's policy is consistent with state statute and the State Administrative Manual. Despite the defendability of the board's overall model, the board needs to refine and correct its model for determining the rate.

STJs Charged for Work in Counties Without STJs

The board includes in the costs allocated to STJs costs related to program elements of registering taxpayers, processing returns, auditing taxpayers, and collecting taxes receivable in counties that do not have STJs. The contributions to shared costs for these tax program elements should be reduced by the portion of activity that relates to counties that do not have STJs. If the board had made these adjustments in their development of the rate, the costs charged to STJs would have been reduced by $2.5 million.

Allocations Between Counties With STJs Based on Revenue Benefits

The board's method of developing the reimbursement rate would overcharge STJs located in counties with two STJs by $2.2 million; it would undercharge STJs located in counties with one STJ by the same amount because the board has not allocated costs between these two types of STJs based on the work load for each. The board allocates most costs between these two based on the proportionate share of revenue they collect. However, the proportionate share of revenue collected is not directly related to the cost of administering the tax collection program for these two types of STJs.

Accordingly, the board should use work load standards to assign costs based on the amount of work performed for STJs in counties with one and in counties with two STJs.

Rates Not Adjusted for Over or Under Collection in Previous Periods

The board's model for setting the STJ reimbursement rate does not adjust the rate when reimbursements for administration of STJ taxes have been over or under collected in prior periods. As a result, the State subsidizes the STJs, or the STJs subsidize the State. For example, the board calculated that, in fiscal year 1988-89, it collected $1.4 million more than the cost for administering the STJs; however, the board did not include an adjustment for this amount in the rates developed in 1990.

Recommendations

To ensure that the STJs pay an equitable reimbursement rate, the board should take the following actions:

- Exclude the costs for registering taxpayers, processing returns, auditing accounts, and collecting taxes receivable that are related to counties that do not have STJs from costs that are shared between the State, cities/counties, and STJs;

- Use a work load standard basis for allocating costs between STJs located in counties with one STJ and STJs located in counties with two STJs; and

- Incorporate an adjustment mechanism into the model that considers the over or under collection of reimbursement during the previous period.

Other Matters for Consideration

The administration of the STJ program is more complicated than the administration of state and city/county tax programs. The state and city/county taxes are uniform in that all counties have them and all counties have the same rate. However, only some counties have STJs, and the counties that do have STJs have different tax rates depending on the rate(s) in the tax ordinance and the number of STJs in the county. Furthermore, while the Bradley-Burns tax relates to the point of sale, the STJ tax taxes goods at the point of sale or use. As a result, businesses incur expense accounting for where an item is sold as well as for whether items were delivered to one of 21 counties containing STJs. Additionally, the board incurs expense processing and auditing data to ensure that the location of delivery in one of 21 counties with STJs, if any, was correctly recorded. The cost of administering this difference between the tax systems accounts for approximately 38 percent of the reimbursement rate presently in legislation, or approximately $8 million in STJ costs in the development of fiscal year 1990-91 rates. The Legislature may want to reconsider the benefit of any differences between the two taxes now that the environment that led to the differences has changed.

Agency Comments

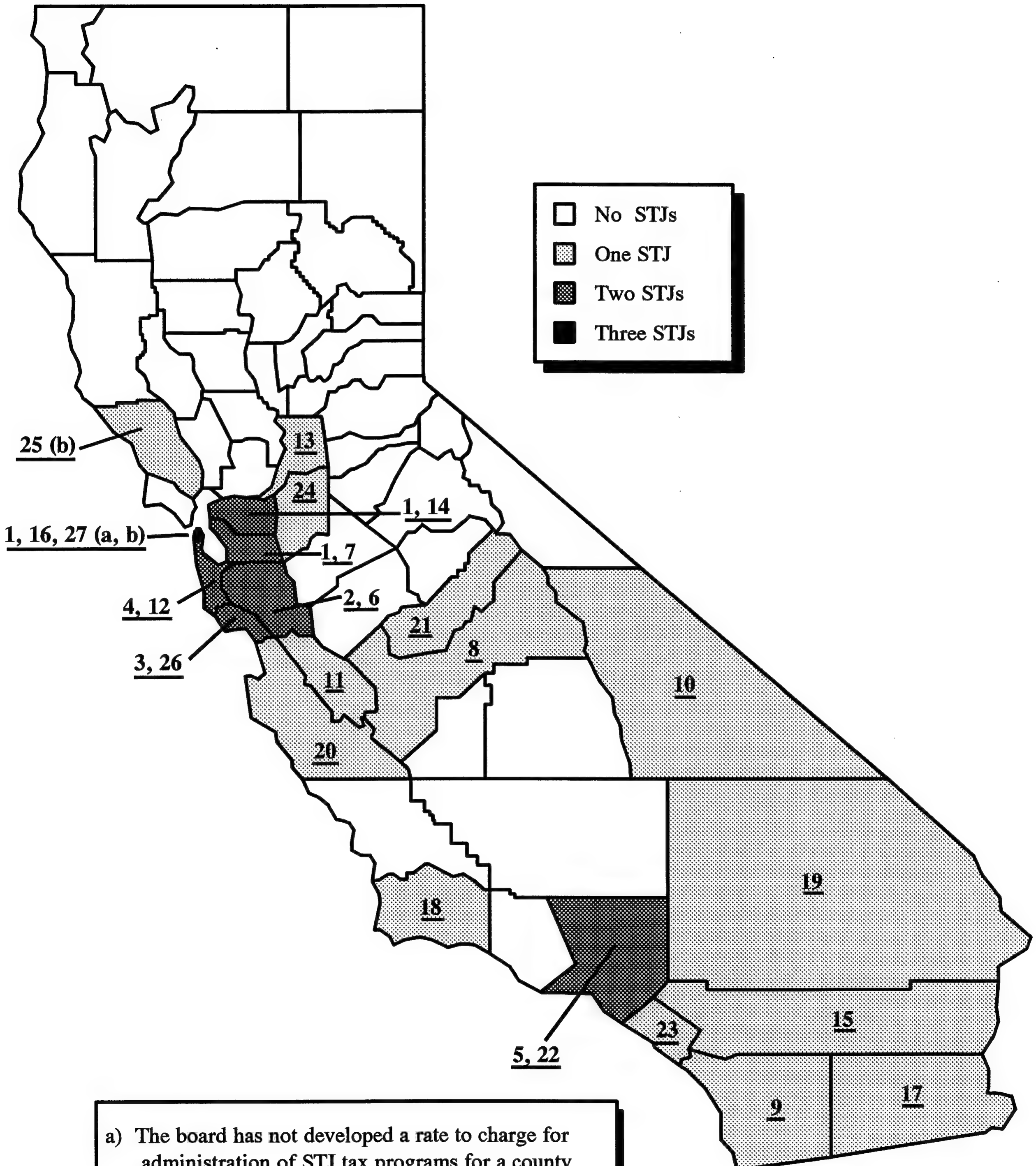
The staff of the Board of Equalization is in conceptual agreement with the refinements of the reimbursement rate-setting model reflected in the report's recommendation section.

Introduction

The Board of Equalization (board) is responsible for 18 tax programs that support state and local government activities. The board administers more tax programs than any other state department, generating taxes exceeding $32.2 billion: $25.8 billion for the state treasury, $6.4 billion in local sales and use taxes, plus $805 million in local funds derived from local property taxes on utility rolls prepared by the board. Among the taxes that the board collects are sales and use taxes and transaction and use taxes, which the board distributes to the State, counties, cities, and special tax jurisdictions (STJ). STJs are created by voters to support transit agencies or other government services. In 1987, the State enacted the Local Transportation Authority and Improvement Act so that local agencies could quickly develop and implement local funding programs to remedy the inadequacies of federal and state funding of current and future local transportation maintenance and improvement needs. Most of the STJs are local transportation authorities.

The board's sales tax program administers the State's sales and use tax, which changed from 4.75 percent to 6.0 percent in July 1991; the 1.25 percent Bradley-Burns Uniform Local Sales and Use Tax; and the transactions and use tax ordinances for STJs. Currently, there are 27 STJs. All have a 0.50 percent tax rate except for the Sonoma County Open Space Authority and the San Francisco Educational Financing Authority, which each have a 0.25 percent tax rate. A listing of the tax jurisdictions and their locations is presented in Figure 1. Recently the California Supreme Court determined the tax implemented by the San Diego Regional Justice Facilities Financing Agency to be an unconstitutional tax under the provisions of Proposition 13. As a result of the ruling, this STJ was eliminated in 1992.

Special Tax Jurisdictions



a) The board has not developed a rate to charge for administration of STJ tax programs for a county that has three STJs.

b) There is no legislated rate for STJs with a one-quarter percent tax rate.

Figure 1

Special Tax Jurisdictions

	Jurisdiction	Implementation Date
1.	Bay Area Rapid Transit District	1970
2.	Santa Clara County Transit District	1976
3.	Santa Cruz Metropolitan Transit District	1979
4.	San Mateo County Transit District	1982
5.	Los Angeles County Transportation Commission	1982
6.	Santa Clara County Traffic Authority	1985
7.	Alameda County Transportation Authority	1987
8.	Fresno County Transportation Authority	1987
9.	San Diego Regional Transportation Commission	1988
10.	Inyo County Rural Counties Transactions Tax	1988
11.	San Benito County Council of Governments	1989
*	San Diego County Regional Justice Facility	1989
12.	San Mateo County Transportation Authority	1989
13.	Sacramento Transportation Authority	1989
14.	Contra Costa Transportation Authority	1989
15.	Riverside County Transportation Commission	1989
16.	San Francisco County Transportation Authority	1990
17.	Imperial County Local Transportation Authority	1990
18.	Santa Barbara County Local Transportation Authority	1990
19.	San Bernardino County Transportation Authority	1990
20.	Monterey County Public Repair and Improvement Authority	1990
21.	Madera County Transportation Authority	1990
22.	Los Angeles County Transportation Commission	1991
23.	Orange County Transportation Authority	1991
24.	San Joaquin County Transportation Authority	1991
25.	Sonoma County Open Space Authority	1991
26.	Santa Cruz Earthquake Recovery Bond	1991
27.	San Francisco Educational Financing Authority	1992

* This STJ was eliminated in 1992 as a result of a California Supreme Court decision.

Figure 1

Rates

The Revenue and Taxation Code sets the rate at which cities/counties and STJs are charged by the State for administering their tax programs. The current rate set in the code is based on the rate-setting model discussed in this report. Since July 1, 1991, the rate for administering the 1.25 percent uniform local tax has been 0.79 of one percent of the revenues collected.

After July 1, 1991, the rate for STJs' 0.50 percent tax became 1.49 percent of the revenue collected for STJs in counties containing a single STJ. Also, when an STJ is established in a county that already has a 0.50 percent tax, the board charges only 1.30 percent of the revenues generated by each taxing district. The rate is set at a lower level for STJs in counties that have more than one STJ because of the efficiencies attained in dealing with two or more STJs that are in the same county.

The following simplified example will illustrate the current rates. A county experiencing sales of $3.5 billion would generate $43.75 million in tax revenue for the cities/counties before deducting the rate charged by the board for administration of the tax programs. The board would deduct $345,625, or 0.79 of one percent, from the cities/counties' revenue, so the cities/counties would receive a net amount of approximately $43.4 million. If the county contained one STJ with a 0.50 percent tax, $17.5 million in tax revenue would be generated for the STJ. The board would deduct $260,750, or 1.49 percent, from the STJ revenues, so the STJ would receive a net amount of approximately $17.2 million.

If, however, there were two STJs in the county with a 0.50 percent tax each, the board would deduct 1.30 percent of tax revenue for each STJ. If each STJ generated $17.5 million tax revenues, each would be charged $227,500 for the administration of the STJs. As a result, the net amount of STJ income in the county would be $34.5 million, and the board would receive $455,000 for its services.

The reimbursement rate for STJs, which is applied to revenues received, exceeds the rate set for the state and local government. This is because the rate-setting model allocates direct costs to STJs in addition to the shared costs, which are allocated on the basis of the portion of revenue that the State, cities/counties, or STJs generate. The board allocates minimal direct costs to the State and cities/counties because there are few costs that are incurred specifically for the State or the cities/counties.

Although the STJ rate is set higher than the rate for the State and cities/counties, the STJs pay less than the State or cities/counties for the processing of each return. For example, if a tax return from a county with one STJ with a 0.50 percent tax rate reports taxable sales of $22,000, the State would receive $1,320 in tax revenues, at the rate of 6.0 percent, and would pay $10.30 for the return processing, at the rate of 0.78065 of one percent of revenues. The cities/counties would receive $275 in tax revenues, at the rate of 1.25 percent, and would pay $2.18 for the return processing, at the rate of 0.79213 of one percent of revenues. The STJ with a 0.50 percent tax rate would receive $110 in tax revenues and would pay $1.64, at the rate of 1.49 percent of revenues, for the return processing. In this case, the total cost for processing the return would be $14.12, and the STJ's portion of the cost would be 12 percent.

When the current rates were developed in 1990, only 21 STJs existed in 17 counties. Since then, 7 counties have passed ordinances establishing additional STJs, and one STJ has been eliminated as a result of a recent California Supreme Court decision. Two of the new STJs, located in Sonoma and San Francisco counties, passed a tax ordinance at the rate of 0.25 percent.

The model that the board developed to determine a reimbursement rate for the administration of local taxes includes several factors: (a) the board estimates the revenues it will collect from each STJ during an upcoming fiscal year based on how much revenue the Department of Finance estimates the State will collect in state sales taxes and (b) the board estimates how much operations will cost during the same period. The board then divides the total costs by the total revenues to determine the reimbursement rate.

Costs

As discussed in Appendix A, the costs that the board identifies for administration of STJs fall into the three general categories of direct, shared, and central agency costs. The cost categories are described in Figure 2.

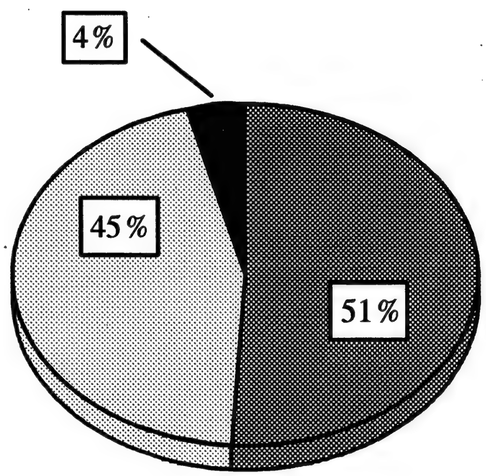
Figure 2

Costs Allocated to STJs

Direct Costs: costs associated directly with each of the tax programs that are developed based on work load standards and other forms of cost measurement.

Shared Costs: the cost of the tax collection system that benefits the State, cities/counties, and STJs individually and jointly but that cannot be separately identified as being directly incurred by the State, cities/counties, and STJs.

Central Agency Costs: the estimated cost of services incurred by central service departments for the benefit of all state departments, such as the state controller issuing warrants and the state treasurer cashing warrants.



Costs (in millions)	
Direct costs	$ 9.4
Shared costs	10.5
Central agency costs	.9
Total	$ 20.8

Source: Board of Equalization.

The board determines a charge rate for STJs by dividing total estimated costs—the sum of the central, shared, and direct costs—by estimated revenue. For example, when the board developed the rates for STJs located in a county with a single STJ effective July 1, 1991, it determined that the total cost of administering these STJ collections was $10,073,000. The board also estimated that the total revenues for these counties would be $674,436,000. By dividing the total estimated costs by the estimated revenue, the board determined that the administration rate should be set at 1.49 percent. This calculation is shown in Appendix B.

Scope and Methodology

The purpose of this audit was to determine whether the board charges STJs for the administration of their tax programs based on a model that is conceptually sound and reasonably supported by detailed calculations.

We analyzed the conceptual soundness of the model to determine if there was a reasonable basis to charge shared costs, direct costs, and central service costs; if shared costs were being charged to STJs only for services that benefited them; if the different rates for STJs in counties with one STJ and for those in counties with two STJs were based on differences in services performed; if there was a method to subsequently correct for errors of estimate in the rate caused by differences between estimated and actual revenues and expenditures and the addition of new STJs; and if the board used work load standards that were quantifiable when developing direct costs.

We analyzed the reasonableness of the support for the detailed calculation by reviewing for mathematical accuracy, consistent use of work load indicators, and inclusion of relevant costs.

We did not audit the work load standard data provided by the board, nor did we perform a work load study. We relied upon statistical data provided by the board for key data such as the number of permits, number of returns, number of audit hours, and amount of taxes receivable collected.

We recalculated the rates using our corrections and refinements, which we have identified in this report. See Appendix B for the rates as calculated by the board. See Appendix C for the rates adjusted for the corrections and refinements we identify in this report.

Finally, we determined how STJ revenues would be affected by changing the STJ tax so that it is more consistent with the Bradley-Burns tax collected for cities and counties.

Chapter: The Board of Equalization Needs To Adjust Its Model for Setting Reimbursement Rates for Special Tax Jurisdictions

Chapter Summary

We reviewed the Board of Equalization's (board) model for developing reimbursement rates to charge special tax jurisdictions (STJ) for administration of tax programs. The board's basic model for setting these rates, which incorporates direct, central agency, and shared costs, is a defendable model because it distributes the cost of the tax administration system among the parties that benefit from it based on the percentage of revenue collected. However, the board needs to adjust some aspects of the model so that its rates are more equitable to both the State and to the STJs. For example, the board's rate for reimbursement inequitably includes charges to STJs for $2.5 million for a portion of the costs related to registering taxpayers, processing returns, auditing taxpayers, and collecting delinquent taxes in counties that do not have STJs. Also, the rate of reimbursement from STJs located in counties with two STJs includes charges of $2.2 million that should have been included in the rate of reimbursement from STJs located in counties with one STJ because the board did not equitably allocate these STJ costs based on the amount of work associated with administering the tax collection program for the STJs. Additionally, the board's model does not have a feature that corrects for misallocations of costs between the State, cities/counties, and STJs in prior periods caused by differences between estimated and actual revenues and the addition of new STJs. Further, the board's rate for reimbursement excludes charges to STJs for approximately $500,000 because the board made errors in its calculations; the errors amount to approximately 2.4 percent of the total amount charged to STJs in the development of reimbursement rates. Finally, the board has limited assurance that some costs allocated to STJs are reasonable because the board does not use work load standards that are quantifiable when determining the costs in some areas.

The Board's Rate-setting Model Is Defendable

There are two basic approaches the board could take in determining the costs of administering the STJ tax programs and the corresponding rate to charge the STJs. One approach is to charge the STJs just the incremental costs of performing the duties needed to administer the STJ tax program. This method does not assess charges for any of the board's costs that would exist whether or not the board provides services to the STJs, even though these costs must exist to provide the services. These excluded costs are for program activities that serve to support the administration of both state and local tax programs. The incremental costs would be associated only with the STJ cost centers as described in Appendix A. With this approach the STJ reimbursement rates, considering the refinements addressed in this report, would be approximately one-half the rate as currently calculated using a shared cost approach. Charging STJs only the incremental cost of the tax collection system can be supported based on the concept that local governments should have to reimburse the State only for costs that the State would not otherwise be incurring to administer its programs.

The other approach is to include the board's existing costs when determining the costs of administering the STJ tax programs. This is the approach the board uses in developing its rates. The board's basic model for setting a rate includes direct, central agency, and shared costs. (The development of these costs is described in Appendix A.) The direct costs are those that the board can identify specifically with the cost of performing services for the STJs; these are the incremental costs described previously. Central agency costs are costs incurred by central service departments and the Legislature for overall administration of state government and for centralized services to state departments. Shared costs represent the cost of program activities that serve to support the administration of both state and local tax programs, but these cannot be separately identified with either state or local taxing jurisdictions. The board justifies charging STJs for a portion of the entire tax collection system and for the incremental cost of collecting taxes for STJs based on this concept: since it administers a tax collection program for the STJs as well as for the cities/counties and the State, all three parties should pay for their fair share of the entire cost of the tax collection system.

The board's method is to charge STJs for a portion of the cost of the entire tax collection system by allocating the shared costs on a basis of benefit received. Doing so, the board recognizes that the State, cities/counties, and STJs benefit jointly and individually by the board's existing systems and administration. Accordingly, each has an interest in the board's established systems in the amount of their respective percentages of total revenues. Consequently, the State, cities/counties, and STJs pay for the board's systems to the degree that each benefits from them. For example, the board estimates that the STJs generate 7.55 percent of the total revenue received by the combined tax programs. Accordingly, the board allocates 7.55 percent of the shared costs to the STJs. The board's method does not conflict with Revenue and Taxation Code, Section 7273, which directs the board to charge "for its services in administering the transaction and use tax ordinance." Furthermore, the board's method is consistent with Section 8752 of the State Administrative Manual, which indicates that the State's policy is to recover full costs whenever goods or services are provided for others. The Legislature passed legislation that included specific rates for reimbursement based on a model that included shared costs.

Based on the model that supports the rates presently in legislation, as adjusted by the refinements discussed later in this report, the STJs would be charged $1.4 million for the benefit of the board's existing system, which registers approximately 825,000 permits; $1.1 million for the benefit of the board's system, which processes approximately 4 million returns; $4.2 million for the benefit of the board's auditing system, which spends approximately 954,000 hours annually performing field audits on businesses in counties containing STJs; and $1.3 million for the benefit of the board's taxes receivable collection system, which collected taxes receivable of $28.3 million for the STJs in fiscal year 1989-90.

These shared costs, totaling $8 million, represent 43 percent of the total charges to STJs of approximately $18.7 million in the revised development of the rates to charge STJs for the board's services. Although the rate charged to STJs could be reduced by

43 percent for shared costs and another 4 percent for central agency costs if it included only the incremental cost of collecting taxes for STJs, we believe the board's method of charging the STJs for their revenue benefit portion of the costs related to the administration of a tax program is defendable. Each of these functions is integral to the administration of a tax program for the STJs. Moreover, the Legislature did not direct the board to limit the reimbursement rate to the incremental cost of administering a tax program for STJs, and the board's method is consistent with the State's policy of recovering full costs whenever goods or services are provided for others.

STJs Charged for Work in Counties Without STJs

Despite the defendability of the board's overall model, the board's method of allocating shared costs on a revenue benefiting basis resulted in STJs being charged a portion of the cost of processing transactions related to counties that did not have STJs. Shared costs include the portion of the cost of registering taxpayers, processing returns, auditing returns, and collecting taxes receivable that cannot be directly identified as relating to the State, cities/counties, and STJs. Appendix A describes in detail the board's method of allocating these costs on a revenue-benefiting basis.

We believe that STJs should be charged for the shared cost of processing transactions related only to counties that have STJs because it is not equitable to charge STJs for costs incurred where there is no STJ activity. The board does not reduce total shared costs by the amount of costs in counties that have no STJs before it allocates shared costs. As shown in the following table, we have reduced the cost of these processes by $33.1 million, the amount related to transactions that occurred in counties without STJs. The amount of reduction was based on work load standards. For example, in the program element of taxpayer registration, we believe that the portion of permits registered in counties that have STJs is an appropriate work load standard since the board processes a permit when a taxpayer registers with it. In the program element of processing returns, we believe the appropriate work load standard is the portion of returns processed in counties that have STJs since the board's processing units handle individual returns.

In the program element of auditing accounts, we believe the portion of field audit hours worked in counties that have STJs is the most appropriate measure of work. Finally, in the program element of collecting taxes receivable, we believe the portion of collections of taxes receivable made in counties with STJs is the appropriate work load measure.

Revision of the Board's Computation of Shared Costs for STJs

	Registering Taxpayers	Processing Tax Returns	Auditing Accounts	Collecting Taxes Receivable	Total Shared Costs
Sales Tax Program Costs Less Unrelated Costs	$25,597,108	$28,540,462	$72,669,088	$21,672,072	$148,478,730
Less STJ Cost Centers:					
Return review		2,468,234			2,468,234
Central files		481,913			481,913
Word processing		243,829			243,829
Account reference		31,280			31,280
Accounting		243,156			243,156
Local tax unit		1,936,694			1,936,694
Field audit			4,068,763		4,068,763
Audit section			218,863		218,863
Total STJ Cost Centers Allocated		5,405,106	4,287,626		9,692,732
Total Shared Costs	25,597,108	23,135,356	68,381,462	21,672,072	138,785,998
Less NonSTJ Costs	7,445,794	8,386,596	12,262,981	5,043,830	33,139,201
Shared Costs Related to STJs	18,151,314	14,748,760	56,118,481	16,628,242	105,646,797
STJ Cost Sharing Factor	0.0755486	0.0755486	0.0755486	0.0755486	0.0755486
STJ Shared Costs[a]	$ 1,371,306	$ 1,114,248	$ 4,239,673	$ 1,256,241	$ 7,981,468

[a]These shared costs are included in the revision of the board's computation of reimbursement rates for the state-administered local taxes as presented in Appendix C.

We realize that some STJs benefit from the registration, processing, auditing, and taxes receivable collected related to businesses in counties which do not have STJs. For example, if a

business in a county with no STJs ships goods to a county with an STJ, the STJ tax is charged on the transaction, and the STJ receives the revenues. Ideally, an adjustment for this amount should be in the model also. According to a board representative, this information is currently not available. However, we do not believe that the amount of this adjustment is material, and it will become less material as STJs are formed in more counties.

We compared the method of using work load standards to identify the costs that would not pertain to STJs with the board's current method of allocating shared costs. We determined that the board included $33.1 million in shared costs for which the STJs should not have had to pay. Since STJs are charged for 7.55 percent of all shared costs, the STJs were charged $2.5 million of the $33.1 million for the cost of transactions that did not relate to STJs.

Allocations Between Counties With STJs Are Based on Revenue Benefits

The board's method for allocating direct and shared costs between STJs located in counties with one STJ and those located in counties with two STJs resulted in the latter including more of the total STJ costs than it should have. The board allocates all shared costs and some of the direct costs on a revenue-benefiting basis, that is, the portion of benefit that the State, cities/counties, and STJs receive from the system. For example, STJs receive 7.55 percent of the total revenues generated by the board's administration of the sales tax program, and accordingly, 7.55 percent of the shared costs are allocated to the STJs. Furthermore, STJs in counties with one STJ receive 45 percent of total STJ revenues, and STJs in counties with two STJs receive 55 percent of total STJ revenues. Accordingly, the board allocates the respective portion of STJ costs to each. The costs to which the STJs contribute are in all four program elements of the sales tax program: registration of taxpayers, processing tax returns, auditing accounts, and collecting taxes receivable.

We believe that the costs would be allocated more equitably based on a work load standard that is most closely related to the work being performed in each of the program elements. We identified the work load standard that more appropriately describes

the work performed in each of the program elements, as discussed earlier. For each of the program elements, we identified the portions of resources spent on counties with one and two STJs and applied these portions to the cost. For example, for the program element of registration of taxpayers, we identified what portion of permits filed in counties with STJs were filed in counties with one STJ and in counties with two STJs. Of permits filed in counties with STJs, the portion filed in counties with one STJ was 63 percent, and the portion filed in counties with two STJs was 37 percent. Accordingly, we believe that 63 percent of registration shared costs should be allocated to STJs in counties with one STJ, and 37 percent of these shared costs should be allocated to STJs in counties with two STJs. Instead, the board's method of allocating shared costs and some direct costs on a revenue-benefiting basis allocates 45 percent of costs to STJs in counties with one STJ and 55 percent of costs to STJs in counties with two STJs.

If the board changed its method of distributing costs between STJs in counties with one STJ and two STJs, the rate for STJs in counties with two STJs would include a smaller portion of costs than would the rate for STJs in counties with one STJ. Taking into consideration the other refinements discussed in this report, the board's method of distributing costs on a revenue-benefiting basis would have resulted in 49.8 percent of total STJ costs being allocated to the rate for counties with one STJ while the remaining 50.2 percent of total STJ costs would have been allocated to the rate for counties with two STJs. With the method of using work load standards for allocating costs, the rate for STJs in counties with one STJ would include 61.5 percent of total STJ costs, and the rate for STJs in counties with two STJs would include the remaining 38.5 percent. The board's method of allocating costs distributes approximately $2.2 million to STJs in counties with two STJs that should be included in the rate for STJs in counties with one STJ. The rates as developed by the board are presented in Appendix B. We present a revised development of the rates in Appendix C, which includes the impact of this refinement in addition to the other refinements and corrections discussed in this report.

Rates Not Adjusted for Over or Under Collection in Previous Periods

The board's model does not adjust the rate to compensate for over or under collecting reimbursements for administration of STJ taxes in prior periods. For example, the board developed information on the amount of STJ reimbursement that exceeded the board's costs of administering the tax programs in fiscal year 1988-89; however, the board did not use this information when it developed new rates in 1990. The reimbursement rate is set in this model by dividing the projected costs by estimated revenues. The rate is then applied to the revenues received. Over collections occur when revenue projections are significantly underestimated. When the revenues are overestimated, the rate is set too low for the board to recover the costs. Additionally, unanticipated increases in the cost of administering the STJ tax programs, as can happen with the addition of new STJs, can cause the administration of STJs to be underfunded, resulting in the State's subsidizing the cost of administrating STJ programs. Conversely, when costs are overestimated or revenues are underestimated, the STJs end up paying for more than the cost of administrating the STJ programs. In this case, the amount overpaid would be absorbed by the State's General Fund, and therefore, the STJs would be subsidizing the State.

We would expect a rate-setting model to include a method of adjusting the rate by the amount of reimbursement over or under collected in the previous period. The board already is required to develop this information per Section 7273.2 of the Revenue and Taxation Code, which states that the board shall annually prepare a report showing the amount of reimbursed and unreimbursed costs it incurred in administering local transportation authorities. Twenty of the 27 STJs are local transportation authorities. Furthermore, to capture and retain the impact of these adjustments effectively, we would expect that the model be used to determine and legislate new rates periodically. The board's redevelopment of the reimbursement rate should not be so frequent as to be burdensome and costly to the administration of STJs but frequent enough to address the inequity of over or under collecting reimbursements.

The board does not revise the rates periodically because the Revenue and Taxation Code does not state the period for which the legislated rate is valid. Before the legislation of the new rates in

1991, the old rates were in effect for 19 years without revision. The adjustment for over or under collection would need to occur when the rates are revised because the adjustment would affect the rate that the board would charge the STJs. Furthermore, the adjustment amount should cover a recent and brief period if it is to be meaningful to the STJs that pay the reimbursement rate. If the adjustment were not performed periodically and frequently, recently formed STJs would pay a rate that does not minimize the effect of adjustments for periods when the new STJs did not exist.

The board determined that, in fiscal year 1988-89, the General Fund recovered approximately $3.3 million more than its costs for administration of local taxes. Of this amount, the General Fund recovered approximately $1.4 million more than its costs for administration of STJs, or approximately 9 percent of total reimbursement collections. Accordingly, for this period, the STJs subsidized the State's operation.

The Board's Model Has Some Errors in Calculations and Approach

The present reimbursement rate includes some incorrect charges and excludes other valid charges to STJs. The rate includes incorrect charges to STJs of approximately $485,000 resulting from two errors in the board's development of costs in the local tax unit. One error was that the board did not consistently use the appropriate work load standard of the number of tax returns processed when developing the local tax unit costs. Instead, it used this work load standard for only part of the cost development, also using the work load standard of the number of permits registered for cost development. Additionally, the board made an error when calculating the cost per personnel year in the local tax unit, which resulted in the board's using $55,316 as the cost per personnel year instead of the appropriate cost of $47,952 per personnel year. In another error, the board excluded from the rate valid charges of $1,035,000 for work auditors performed for STJs in the out-of-state offices. Furthermore, the rate incorrectly charges STJs $50,000 for central agency costs for items that already include central agency costs.

We believe a reasonable model should include the consistent use of work load standards, include all relevant calculations, and include identifiable charges for effort performed on behalf of STJs. Also, a reasonable model should not include charges for the same service twice.

As a result of these errors, the reimbursement rate presently in legislation is based on a model that understates charges to STJs by $500,000, which represents approximately 2.4 percent of the total amount charged to STJs in the development of reimbursement rates.

Work Load Standards Not Always Quantifiable

The board does not have work load standards that are quantifiable for all direct costs. For example, the field audit section estimated, without performing any studies, that when a county has an STJ, the field audit hours are increased by 5 percent, and when a county has two STJs, the field audit hours are increased by 6 percent. This estimate, which is the basis for $3 million of the $20 million in charges to STJs in the reimbursement rate, was developed by the principal tax auditor and reviewed by the staff in several district offices. The staff in the several district offices believed the percentages to be reasonable.

We believe an estimate of the incremental time needed to audit in counties with STJs can be cost effectively developed based on actual hours in a sample of audits in the district audit offices and in the out-of-state audit offices. When the board uses estimates of the incremental time needed to audit rather than work load factors with a quantitative basis, the board has limited assurance that the costs identified with STJs are reasonable.

Conclusion

The board is using a defendable approach in its model for developing STJ reimbursement rates, which shares the cost of the tax administration system among the parties that benefit from it based on the percentage of revenue collected. However, this model needs to be refined. For example, the board includes in its reimbursement rate for STJs $2.5 million in costs for counties that do not have STJs. Also, the rate for reimbursement for STJs in counties with two STJs included charges of $2.2 million that should have been included in the rate for STJs in counties with one STJ. Additionally, the board's model does not have a feature that corrects for misallocations of costs between the State, cities/counties, and STJs in prior periods caused by differences between estimated and actual revenues and the addition of new STJs. Further, the board's rate for reimbursement excluded charges to STJs for approximately $500,000 because the board made some errors in its calculations. Finally, the board has limited assurance that costs allocated to STJs are equitable because it does not use quantifiable work load standards when determining the costs in some areas.

Recommendations

To ensure that the STJs pay an equitable reimbursement rate, the board should take the following actions:

- Exclude the costs for registering taxpayers, processing returns, auditing accounts, and collecting taxes receivable related to counties that do not have STJs from costs that are shared between the State, cities/counties, and STJs;

- Use a work load standard basis for allocating STJ costs to STJs in counties with one STJ and to those in counties with two STJs;

- Incorporate an adjustment mechanism into the model that considers the over or under collection of reimbursement during the previous period;

- Seek legislation requiring the revision of the reimbursement rate every two to three years;
- Review its calculations to ensure that they are correct; and
- Develop a method to better quantify existing work load standards.

Other Matters for Consideration

The administration of the STJ-imposed transaction and use tax program may become unduly cumbersome and expensive as additional STJs are formed. It is more complicated than the administration of the Bradley-Burns Uniform Sales and Use Tax program (Bradley-Burns tax) through which taxes are collected for cities and counties. The city/county taxes are uniform in that all counties have them and all counties have the same rate. However, only some counties have STJs, and the counties that do have STJs have different tax rates depending on the rate set for the STJ and the number of STJs in the county. Furthermore, while the Bradley-Burns tax relates to the point of sale, the STJ tax relates to the point of sale or use. As a result, businesses incur expense accounting for where an item is sold as well as for whether items were delivered to one of 21 counties containing STJs. In addition, the board incurs expense processing and auditing data related to where an item is sold as well as significant additional expense processing and auditing data to ensure that the location of delivery in one of 21 counties containing STJs, if any, was correctly recorded. The differences between the two taxes and the extent of the additional recordkeeping involved is displayed on the additional schedule to compute STJ taxes and the related instructions located in Appendix D.

The cost of administering this difference between the two types of taxes could account for approximately 38 percent of the rate presently in legislation to reimburse the State for administering this program. As additional STJs are formed, this percentage will increase, as will the administrative cost to businesses. If both the

Bradley-Burns and the STJ tax were based on the rate in effect at the point of sale, STJs would have to pay only for their proportionate share of administering the existing tax program; they would not pay for the cumbersome and expensive administration of the difference between the two programs.

The emphasis on point of delivery rather than point of sale appears to address concerns that existed when the initial STJ legislation was passed. These concerns would be applicable in an environment where there are few STJs or where STJs are in counties that have a small percentage of taxable sales. However, presently, approximately 88 percent of all taxable sales occur in the 21 counties with at least one STJ, and new STJs are forming rapidly. The cost to administer the differences by both the State and private businesses increases with the addition of new STJs, with decreasing benefits.

We estimate that if the STJ tax had been more consistent with the Bradley-Burns tax, an additional amount of approximately $20 million would have been generated for STJs during the period of August 14, 1990, through August 13, 1991. For 11 of the 20 STJs in existence during this entire period, their income would not have varied by more than 3 percent. However, a few STJs would have been significantly affected. For example, the revenues of two STJs in San Mateo would have increased approximately 19 percent, and the revenues of the STJ in Inyo County would have decreased approximately 12 percent. In addition to the $20 million that the STJs could have received if the STJ tax were more consistent with the Bradley-Burns tax, the STJs would have benefited by approximately $8 million, the cost to administer the difference between the Bradley-Burns and the STJ taxes.

The Legislature may want to reconsider the benefit of any differences between the two taxes now that the environment that led to the differences has changed.

We conducted this review under the authority vested in the auditor general by Section 10500 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,

KURT R. SJOBERG
Auditor General (acting)

Date: March 23, 1992

Staff: Philip J. Jelicich, CPA, Audit Manager
Kay E. Overman

Appendix A The Board of Equalization's Process for Setting Reimbursement Rates for Special Tax Jurisdictions

The Board of Equalization (board) estimated that its total costs for administering tax collection and distribution to special tax jurisdictions (STJ) would be $20,823,506 for fiscal year 1990-91. This total comprises three categories: shared costs, direct costs, and central agency costs, which are listed in the following table.

Costs Allocated to STJs
Fiscal Year 1990-91

	Costs Allocated		Percentage of Total Costs	
Shared Program Costs		$10,563,151		51%[a]
Direct Costs:				
Department of Motor Vehicles	$1,139,208		5[a]	
Department of Housing and Community Development	6,000		0	
Local tax unit	1,515,658		7[a]	
Field audit	3,035,470		15[a]	
Various cost centers:				
Return review	2,468,234		12[a]	
Central files	481,913		3	
Word processing	243,829		1	
Account reference	31,280		0	
Audit section	218,863		1	
Accounting	243,156		1	
Direct Costs		9,383,611		45
Central Agency Costs		876,744		4[a]
Total		$20,823,506		100%

Source: Board of Equalization

Note: The board's development of these costs includes miscalculations for the local tax and field audit units, the shared costs, and the central agency costs. Corrections are not included here but are discussed in the body of the report and are included in Appendix C.

[a] These six costs, representing 94 percent of the total costs, are analyzed in this report.

Shared Costs

Shared costs for fiscal year 1990-91 represented 51 percent of the total costs assigned to STJs. The board indicates that this cost category represents the cost of program activities that serve to support the administration of both state and local sales and use taxes and transaction and use taxes. To determine total shared costs, the board subtracted from total sales tax program costs all the unrelated costs and all the costs that the board has identified as attributable to a specific function for state, cities/counties, or STJ revenue collection. Essentially, the board identified which costs are not shared costs and considered the remaining costs shared. The board did not identify the amount of shared costs for the individual sections such as return review, central files, and field audits, nor did it determine the amount of shared costs within each program element.

To estimate fiscal year 1990-91 shared costs, the board began with the estimated cost for the sales tax program, as presented in the Governor's Budget. The board's first adjustment was for a 5 percent salary increase that was effective January 1, 1991. The board then reduced the total by the amount of costs unrelated to STJs. These costs included an interagency agreement with the Employment Development Department, which is a cost in the program element of collection of taxes receivable. Additionally, costs incurred by the board for establishing new STJs were subtracted from the sales tax program because they are reimbursed by the STJs that incur the costs. Finally, the costs associated with earthquake relief were also unrelated to STJ tax collection and allocation.

The next group of expenses subtracted from the sales tax program total included direct costs from sources outside the board. The Department of Motor Vehicles (DMV) costs represent the costs of the contract the board held with the DMV so the DMV could collect sales and use tax on vehicles and vessels as they are being registered. The Department of Housing and Community Development costs represent the costs of a contract the board held with that department so the department could collect sales and use tax on mobile home sales.

The final group of expenses subtracted from the sales tax program includes the board's direct cost center portions specifically identified with the administration of STJs. The cost centers are field audit, local tax unit, return review, central files, word processing, account reference, audit section, and accounting. The remaining costs for these centers went into shared costs.

What remains after the adjustments listed above is the total shared cost. The board calculated $114,223,379 as the actual amount for fiscal year 1988-89 and $139,819,291 as the estimated amount for fiscal year 1990-91. Of the total costs for 1990-91, the board allocated them to the State, cities/counties, and STJs based on revenue benefit. For example, the STJs' revenue of $1,501,228,000 comprised approximately 7.5 percent of total revenue of $19,871,024,000. Accordingly, the STJs' portion of shared costs was $10,563,151.

The shared costs were further allocated, on a revenue-benefiting basis, between STJs located in counties with one STJ and those in counties with two. Since STJs in counties with one STJ contributed 45 percent of revenues, 45 percent of STJ shared costs were allocated to STJs in counties with one STJ.

Direct Costs

Of the total estimated costs for STJs, $9,383,611, or 45 percent, were direct costs. The total direct costs comprise costs associated with the DMV, the Department of Housing and Community Development, the local tax and field audit units at the board, and various board cost centers also at the board. The board cost centers included in the direct costs are return review, central files, word processing, account reference, audit section, and accounting.

The DMV costs and Department of Housing and Community Development costs are reimbursements the board makes to these departments for services provided to the board in connection with the collection of sales and use taxes. Each of the remaining costs represent the portion of the units' costs that the board identified as being incurred by its administration of taxes for the STJs.

We reviewed the development of the costs for four of the direct cost categories: DMV, local tax, field audit, and return review. These cost categories comprise 87 percent of the total estimated STJ direct costs.

DMV

The DMV costs are reimbursements the board makes to the DMV for services provided to the board in connection with the collection of sales and use taxes. The DMV collects taxes on vehicles and undocumented vessels. The board has an interagency agreement with the DMV that covers the amount of costs as estimated for the period of the interagency agreement. The estimate is made using a set rate that the DMV charges the board for collecting taxes on vehicles and vessels. However, after the amount is estimated for an upcoming year, the amount that the board will pay the DMV is set. The board does not pay more even if more vehicles and vessels were registered than anticipated. The board passed the DMV costs on to the STJs by including the DMV costs in the STJ rate-development model. The board allocated the DMV costs for STJs between counties with one STJ and two STJs based on the number of vehicles and vessels registered in each.

Local Tax Unit

The board administers local sales taxes for the Bradley-Burns Uniform Local Sales and Use Tax program for cities/counties and the transactions and use tax program for STJs. The local tax unit's sole function is to administer local sales taxes. It works closely with cities, counties, and districts to ensure the proper allocation and distribution of local taxes to the proper cities/counties and taxing jurisdictions.

To provide a steady cash flow to the local entities, the law requires the board to distribute local tax revenues to cities and counties at least twice during each calendar quarter. The board sends estimated advance payments each month based on an analysis of economic conditions, growth patterns, and other pertinent

trends. The board makes a final "cleanup" payment after it processes and accounts for tax returns due for each quarter so that each city, county, and district receives the amount of allocated funds to which it is entitled. Upon request, those funds are deposited by the board in a Sacramento branch of their local bank to make money available sooner and to earn interest for the days during which the funds would otherwise have been enroute by mail.

The work load in the local tax unit consists of reviewing scheduled returns, verifying the tax on the allocation schedule with the amount of tax reported on the return, and determining that proper transactions and use tax for the STJs has been reported. When STJ tax is reported in the wrong district, fund adjustments must be made to correct the distribution of taxes received.

The board's development of cost information for the local tax unit included using work load standards that were developed for fiscal year 1988-89 and used again in the rate calculations for fiscal year 1990-91. Then it increased the STJ costs by the amount of additional positions requested for the local tax unit. The local tax unit's time reporting system does not allow the local tax unit to track the amount of time spent on STJ work and city/county work.

The Board's Determination of Local Tax Unit Costs: In summary, the board determined the local tax unit costs as follows. The estimated number of returns was multiplied by a factor representing the portion of returns generating STJ work load. This product was divided by the number of STJ items processed per personnel year. The quotient is the number of personnel years required for the estimated work load. The estimated personnel years was multiplied by the cost per year to provide the total estimated local tax unit STJ costs for fiscal year 1990-91.

The estimated number of returns as stated in the Governor's Budget for fiscal year 1990-91 was 3,737,000. The STJ work load factor was developed by dividing the number of STJ items on

returns by the number of returns. Of the tax returns received, some do not have any STJ work load because the county submitting does not have an STJ. Some returns reflect one STJ, and some returns reflect more than one STJ. An example of a return with multiple STJs would be one from Contra Costa County. Such a return has the Bay Area Rapid Transit STJ and the Contra Costa Transportation Authority STJ on the same return; thus one return generates an STJ work load of two returns. The board determined the STJ work load factor to be 101.8 percent. Therefore, the estimated STJ work load was calculated to be 3,804,266 items.

The STJ items processed per personnel year is a standard work load factor developed by the board based on actual information from fiscal year 1987-88. In 1987, there was an STJ work load of 2,260,349 returns processed per 16.3 personnel years. The average number of items processed per personnel year was 138,672. The estimated STJ work load was divided by the average number of items processed per personnel year to determine the number of personnel years needed to process the STJ work load. The estimated number of personnel years for fiscal year 1990-91 was 27.4.

The estimated number of personnel years was then multiplied by the cost per personnel year to determine the total local tax unit STJ costs. The cost per personnel year was developed by determining all of the costs associated with the unit and dividing by the number of personnel years in the unit. The costs associated with the unit included the actual salaries and wages for fiscal year 1988-89 adjusted for positions added and deleted, overtime and temporary help costs, and salary increases and savings. Additionally, the costs included operating expenses associated with the unit, a distribution of costs associated with the business tax program administration, a supply unit cost, and a board overhead portion. The total estimated costs were divided by the estimated number of personnel years to determine the cost per personnel year. The board calculated a local tax unit cost per personnel year to be $55,316 for fiscal year 1990-91. By multiplying the cost per personnel year by the number of those years, the board estimated the local tax unit costs to be $1,515,658 for fiscal year 1990-91.

The board breaks down costs between counties with one and two STJs on a revenue-benefiting basis. Counties with one STJ contributed 45 percent of the STJ revenues and, accordingly, were allocated 45 percent of the local tax unit costs. The board allocated the remaining 55 percent in local tax unit costs to counties with two STJs.

Field Audit

According to the board, field auditing ensures uniform compliance with tax laws and serves to protect a state and local tax base projected to be in excess of $20.1 billion during the 1990-91 fiscal year. The audit program is designed to cover the tax base in a manner that will result in audits of accounts most likely to make substantial errors in underreporting. The audit selection system, which is based on the principle of marginal analysis, is designed to audit the most productive accounts producing the largest tax deficiencies. "Tax deficiency" is the difference between self-assessed tax and the greater amount determined to be due through the auditing process.

The field audit section does not use a time reporting system that classifies the work performed by whether it was performed in support of the State, cities/counties, or STJs. The principal tax auditor of the field audit section estimated the amount of additional time the section spends in support of STJs, and this is the basis for determining the costs for STJs. We accepted the estimates as presented and were not able to perform audit work to substantiate the estimates because the board had not performed any studies to derive the estimate.

The field audit costs associated with STJs mainly comprised two elements: STJ field audit hours worked and cost per hour. The STJ field audit hours worked is multiplied by the cost per hour to determine the total field audit costs for STJs.

The field audit hours worked is developed by applying a factor to the number of audit hours associated with counties that have STJs. The board estimated the number of audit hours incurred by

each county based upon the portion of permits in the county to the total permits in the area covered by the district office. For example, Santa Cruz County, a one-STJ county, is covered by a district office that also reviews the counties of San Luis Obispo, Ventura, Santa Barbara, Monterey, and San Benito. The sales tax permits in Santa Cruz County represented 14.85 percent of the 56,084 permits within the jurisdiction of the the district office. Therefore, Santa Cruz County was charged with 14.85 percent of the 28,727 district office audit hours worked, or 4,265 hours.

The principal tax auditor in the field audit unit estimated that it takes the unit an additional 5 percent of audit time to review a county that has one STJ and an additional 6 percent to review a county that has two STJs. Accordingly, the total field audit hours worked for each county with one STJ were multiplied by 5 percent; if a county had two STJs, the total field audit hours worked for each county with two STJs was multiplied by 6 percent. In the case of Santa Cruz County, 213 field audit hours were associated with STJ work. Also the board estimated that counties adjacent to STJ counties also have increased audit time, an additional 50 percent of the STJ audit time. Field audit hours for the STJ in Santa Cruz County were increased by 106.5 hours for a total of 319.5 hours. The audit hours thus derived are summed for all STJ counties. Using this method, the board estimated that the field audit unit spent 56,036 hours to perform audit work for STJs.

The cost per hour comprises direct costs of personal services and operating expense and indirect costs of board administration, supply costs, and board overhead. The board estimated total costs to be $62,148,433. The total costs were divided by the total number of field audit hours to determine the cost per field audit hour. The total field audit hours was 1,147,389. Accordingly, the estimated cost per field audit hour for fiscal year 1990-91 was $54.17.

The estimated cost per hour of $54.17 was multiplied by the STJ field audit hours of 56,036 to determine the total field audit costs associated with STJs. This amount was $3,035,470.

Return Review

The work load of return review consists primarily of desk auditing tax returns reporting or failing to report required STJ taxes. This includes reviewing for arithmetic accuracy, reviewing for questionable tax exempt deductions, identifying incomplete or erroneously prepared returns, billing for additional tax due, refunding overpayments, and providing tax return preparation instructions to taxpayers in response to inquiries.

Based on past experience with existing STJs, the board has found that the incidence of error increases in the total reporting population each time a new district is added. The return review unit has three main sections; verification, billing, and correspondence. Each of these sections experiences a different work load impact driven by the number of returns generating work load, a different items- processed-per-personnel year, and a different cost per personnel year.

To estimate costs for the return review unit, the estimated number of returns was multiplied by the STJ work load factor discussed previously. The board determined this factor to be 101.8 percent. The product, 3,804,266, was multiplied by a separate factor for each of the three sections representing the work load impact. For example, the verification section processes each return received, while the billing and correspondence sections only process returns as needed. These two sections process only 1.5 percent of returns received. This product representing the STJ work load was divided by the number of STJ items processed per personnel year in each of the sections. The quotients represent the number of personnel years required for the estimated work load in each section. The estimated personnel years was multiplied by the cost per personnel year to provide the total estimated return review STJ costs for fiscal year 1990-91. The board estimated return review unit STJ costs were $2,468,234.

The costs were further allocated between counties with one and two STJs on a revenue-benefiting basis. Since counties with one STJ contribute 45 percent of revenues, 45 percent of return review unit STJ costs were allocated to counties with one STJ.

Central Agency Costs

Central agency costs, which comprised 4.2 percent of the costs assigned to STJs for fiscal year 1990-91, are costs incurred by central service departments for the benefit of all state departments. They are those amounts expended by central service departments and the Legislature for overall administration of state government and for providing centralized services to state departments. These functions are necessary for state operations and are centralized to provide efficient and consistent statewide policy and services.

The state policy is for departments to recover full costs whenever goods or services are provided for others. According to the State Administrative Manual, Section 8752, the full cost of goods or services includes all costs attributable directly to the activity plus a fair share of indirect costs that can be ascribed reasonably to the good or service provided. The cost elements included as defined by Section 8752.1 are department direct costs, department indirect costs, and central service costs.

The Board's Determination of a Central Agency Cost Factor

The calculation of the factor involves simply dividing the central agency costs by the board's operating budget net of special funds and exclusions. The factor, therefore, represents the portion of a dollar of central agency costs that goes with each dollar of General Fund costs.

The central agency costs were taken from the information provided by the Department of Finance and from a separate billing from the Department of Justice. The relevant amounts from each source were summed and considered the central agency costs. In developing the net General Fund costs, the board subtracted special funds and other exclusions from total board expenditures. This is appropriate because these were items that do not incur overhead consideration.

The board determined the central agency costs to be \$6,027,113 and the net General Fund costs to be \$137,122,654. Accordingly, the board calculated the central agency cost factor to be .0439542. This factor was multiplied by total costs to determine the central agency costs.

Appendix B

The Board of Equalization's Computation of Reimbursement Rates for the State-Administered Local Sales and Use Taxes and Transaction and Use Taxes Fiscal Year 1990-91 Estimated

	State	Cities and Counties (1 1/4%)	Special Tax Jurisdictions (STJ) One STJ Counties	Two STJ Counties	Subtotal STJs	Total
COST						
Shared Cost	$102,575,772	$26,680,368	$ 4,745,561	$ 5,817,590	$10,563,151	$139,819,291
Direct Cost:						
Department of Motor Vehicles	6,344,689	1,646,103	809,864	329,344	1,139,208	9,130,000
Department of Housing and Community Development	91,310	23,690	2,898	3,102	6,000	121,000
Local tax		421,036	680,919	834,739	1,515,658	1,936,694
Field audit			1,753,320	1,282,150	3,035,470	3,035,470
Various cost centers			1,656,531	2,030,744	3,687,275	3,687,275
Subtotal	109,011,771	28,771,197	9,649,093	10,297,669	19,946,762	157,729,730
Central Agency	4,791,525	1,264,615	424,118	452,626	876,744	6,932,884
Total Cost	$113,803,296	$30,035,812	$10,073,211	$10,750,295	$ 20,823,506	$164,662,614
REVENUE (in thousands)	$ 14,578,000	$ 3,791,796	$ 674,436	$ 826,792	$ 1,501,228	$ 19,871,024
RATE[a]	0.0078065	0.0079213	0.0149358	0.0130024	0.0138710	0.0082866

[a]The rate is calculated by dividing the total costs by the revenue.

Appendix C

Revision of the Board of Equalization's Computation of Reimbursement Rates for the State-Administered Local Sales and Use Taxes and Transaction and Use Taxes Fiscal Year 1990-91 Estimated

			Special Tax Jurisdictions (STJ)			
	State	Cities and Counties (1 1/4%)	One STJ Counties	Two STJ Counties	Subtotal STJs	Total
COST						
Shared Cost	$ 103,804,552	$ 26,999,978				
Program Elements:						
Registration			$ 865,009	$ 506,297	$ 1,371,306	
Processing			700,721	413,527	1,114,248	
Auditing			2,684,091	1,555,582	4,239,673	
Collecting taxes			596,227	660,014	1,256,241	
Subtotal	$ 103,804,552	$ 26,999,978	$ 4,846,048	$ 3,135,420	$ 7,981,468	$138,785,998
Direct Cost:						
Department of Motor Vehicles	6,344,689	1,646,103	809,864	329,344	1,139,208	9,130,000
Department of Housing and Community Development	91,310	23,690	2,898	3,102	6,000	121,000
Local tax		905,726	648,348	382,620	1,030,968	1,936,694
Field audit			2,404,336	1,664,427	4,068,763	4,068,763
Various cost centers			2,318,829	1,368,446	3,687,275	3,687,275
Subtotal	110,240,551	29,575,497	11,030,323	6,883,359	17,913,682	157,729,730
Central Agency	4,558,992	1,225,591	448,745	287,710	736,455	6,521,037
Total Cost	$ 114,799,543	$ 30,801,088	$ 11,479,068	$ 7,171,069	$18,650,137	$164,250,767
REVENUE (in thousands)	$ 14,578,000	$ 3,791,796	$ 674,436	$ 826,792	$ 1,501,228	$ 19,871,024
RATE[a]	0.0078748	0.0081231	0.0170202	0.0086734	0.0124233	0.0082658

[a]The rate is calculated by dividing the total costs by the revenue.

Appendix D Retailers' Tax Calculations in Addition to Their Calculations for State and Bradley-Burns Taxes

The additional recordkeeping and related instructions for the reporting of taxes collected in special tax jurisdictions are presented on the following pages.

SCHEDULE A
COMPUTATION SCHEDULE FOR DISTRICT TAX

BT-401-A (S1&2) REV. 50 (4-91)

SCHEDULE A - COMPUTATION SCHEDULE FOR DISTRICT TAX

A1.	AMOUNT ON WHICH LOCAL TAX APPLIES. (Enter amount from Line 16 on the front of the return)	$ .00
A2.	DEDUCT - Sales made from locations outside districts and delivered to any point not in a district 000	- .00
A3.	DEDUCT - Sales made from locations inside districts and delivered to any point not in a district.	- .00
A4.	AMOUNT OF DISTRICT TRANSACTIONS (Line A1 minus Lines A2 and A3) (Allocate this amount to the correct district(s) in Column A5)	$ .00

READ INSTRUCTIONS BEFORE PREPARING THIS SCHEDULE

Please round cents to the nearest whole dollar

* Transactions in a county with two districts must be reported in Column A5 for both districts.

DISTRICTS BY COUNTY	A5. ALLOCATE LINE A4 TO CORRECT DISTRICTS	A6. ADD (+) ADJUSTMENTS	A7. DEDUCT (–) ADJUSTMENTS	A8. TAXABLE AMOUNT A5 plus A6 minus A7	A9. TAX RATE	A10. DISTRICT TAX DUE Multiply A8 by A9
* ALAMEDA Co. 020 Bay Area Rapid Transit	.00	.00	.00	.00	.005	$ .00
011 * ALAMEDA Co. 010 Transportation Authority	.00	.00	.00	.00	.005	.00
* CONTRA COSTA Co. 021 Bay Area Rapid Transit	.00	.00	.00	.00	.005	.00
025 * CONTRA COSTA Co. 024 Transportation Authority	.00	.00	.00	.00	.005	.00
FRESNO Co. 012 Transportation Authority	.00	.00	.00	.00	.005	.00
IMPERIAL Co. 029 Local Transportation Authority	.00	.00	.00	.00	.005	.00
INYO Co. 014 Inyo Co. Transactions Tax	.00	.00	.00	.00	.005	.00
* LOS ANGELES Co. 005 LACT Effective 7-1-82	.00	.00	.00	.00	.005	.00
036 * LOS ANGELES Co. 035 LATC Effective 4-1-91	.00	.00	.00	.00	.005	.00
MADERA Co. 034 Transportation Authority	.00	.00	.00	.00	.005	.00
MONTEREY Co. 032 Public Repair & Improvement	.00	.00	.00	.00	.005	.00
ORANGE Co. 037 Transportation Authority	.00	.00	.00	.00	.005	.00
RIVERSIDE Co. 026 Transportation Commission	.00	.00	.00	.00	.005	.00
SACRAMENTO Co. 023 Transportation Authority	.00	.00	.00	.00	.005	.00
SAN BENITO Co. 015 Council of Governments	.00	.00	.00	.00	.005	.00
SAN BERNARDINO Co. 031 Transportation Authority	.00	.00	.00	.00	.005	.00
* SAN DIEGO Co. 013 Regional Transportation	.00	.00	.00	.00	.005	.00
017 * SAN DIEGO Co. 016 Regional Justice Facilities	.00	.00	.00	.00	.005	.00
* SAN FRANCISCO Co. 022 Bay Area Rapid Transit	.00	.00	.00	.00	.005	.00
028 * SAN FRANCISCO Co. 027 Transportation Authority	.00	.00	.00	.00	.005	.00
SAN JOAQUIN Co. 038 Transportation Authority	.00	.00	.00	.00	.005	.00
* SAN MATEO Co. 002 Transit District	.00	.00	.00	.00	.005	.00
019 * SAN MATEO Co. 018 Transportation Authority	.00	.00	.00	.00	.005	.00
SANTA BARBARA Co. 030 Local Transportation Authority	.00	.00	.00	.00	.005	.00
* SANTA CLARA Co. 006 Traffic Authority	.00	.00	.00	.00	.005	.00
007 * SANTA CLARA Co. 003 Transit District	.00	.00	.00	.00	.005	.00
* SANTA CRUZ Co. 004 Metropolitan Transit	.00	.00	.00	.00	.005	.00
041 * SANTA CRUZ Co. 040 Earthquake Recovery	.00	.00	.00	.00	.005	.00
SONOMA Co. 039 Open Space Authority	.00	.00	.00	.00	.0025	.00

A11.	TOTAL DISTRICT TAX Add Column A10. (Enter here and on Line 18 on front of return)	$ .00

INSTRUCTIONS FOR COMPLETING SCHEDULE A

A1. Enter the amount subject to local tax (the Bradley-Burns tax) from Line 16 on the front of the return.

A2. Deduct sales made from locations OUTSIDE districts and delivered to any point which is not in a district.

A3. Deduct sales originating from locations INSIDE districts which are shipped to any point not in a district, pursuant to a contract of sale, by delivery by the retailer or his agent, or by delivery by the retailer to a carrier for shipment to a consignee at such point.

A4. District Transactions. Subtract A2 and A3 from A1. Enter the result on A4.

A5. Allocate A4 to the appropriate district(s). If a county has two districts, 100% of the transactions in the county must be entered for each of the county's districts. If you have transactions in a county imposing two district taxes, the sum of all A5 entries will exceed A4. Otherwise, the sum of all A5 entries will equal A4.

A6. Add:

1) That portion of the exempt transactions on the front of the return for bad debts, tax paid purchases resold, returned merchandise or cash discounts which were deducted from current sales, but originally taxed at a rate lower than the current rate.
2) The purchase price of goods on which the state and local tax was paid to the vendor but not the district tax and a taxable use was made in the district. This might occur in instances where property was purchased from a vendor who charged tax at a rate lower than the rate in effect where the use was made.

A7. Deduct:

1) Sales of property which the seller is obligated to furnish for a fixed price pursuant to a contract entered into prior to the effective date of the district tax.
2) Leases of tangible personal property which are continuing sales during any period of time for which the lessor is obligated to lease the property for an amount fixed by the lease prior to the effective date of the district tax.
3) Amounts upon which district sales or use tax was imposed by other districts and paid by you on goods for use in another district. The purchase price must also be entered on A6 in the district of use.
4) Sales of tangible personal property (other than vehicles, aircraft and vessels) delivered into a district in which you are not engaged in business.

A8. Amount subject to district tax. A5 plus A6 minus A7. Enter the result on A8.

A10. District tax due. Multiply A8 by A9. Enter the result on A10.

A11. Add all A10 entries and enter total on A11 and on Line 18 of the return.

STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
1020 N STREET, SACRAMENTO, CALIFORNIA
(P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001)

March 16, 1992

Mr. Kurt R. Sjoberg
Auditor General (Acting)
Office of the Auditor General
660 J Street
Sacramento, CA 95814

Dear Mr. Sjoberg:

Thank you for the opportunity to review and comment on your draft report entitled "The Board of Equalization Needs to Adjust its Model for Setting Reimbursement Rates for Special Tax Jurisdictions".

The staff of the State Board of Equalization have reviewed your report and have informed me that they are in conceptual agreement with the refinements of the reimbursement rate setting model reflected in the reports recommendation section. However, since our Board Members will not meet prior to the requested comments response date, the staff's position is still subject to their approval.

If you have any questions or need any additional information, you may wish to have your staff contact Judy Agan (Deputy Director, Administration) at 445-4272 or Ed Steele (Chief, Budget Division) at 445-3811.

Sincerely yours,

Burton W. Oliver
Executive Director
State Board of Equalization

BWO:bah

cc: Members of the Legislature
Office of the Governor
Office of the Lieutenant Governor
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps